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Monday, June 09, 2008

U.S. Supreme Court breathes new life into first sale rule

The United States Court of Appeals for the Federal Circuit, which usually has the final say on most U.S. patent appeals, and thus the most influence on the development of U.S. patent law, has recently been eroding conservation of rights, the principle that you cannot sell or claim more than you own, and in particular that you can't reclaim it once you sell it. Under the patent exhaustion rule, which is as old as patent law itself, patent rights are exhausted upon the first sale of an object embodying the patent. The patent holder is effectively allowed to sell the patent rights once per object, rather than maintaining control shared control over the object with the object's owners and possessors through its entire lifetime. The patent holder is allowed to collect a royalty only once per object. Once the first sale occurs, the object reverts from being held in a tangle of intellectual property, with a potential wide variety of "owners" imposing a wide variety of restrictions, to being owned outright by a single person or express partnership as traditional (i.e. real or personal) property.

The Federal Circuit has eroded this principle in a number of ways: by ignoring foreign sales (so that for example an object first sold in Canada under a Canadian patent, then imported into the U.S., comes under the thrall of the equivalent U.S. patent), by excluding certain kinds of patents from the rule, and by changing the default rule for implied licenses (i.e. ruling that the default implication was that resale was not allowed, effectively extending patent rights beyond the first sale), etc. In some cases patent rights seem to disappear, but then reappear later on in the lifetime of the object. In other cases the patent holder maintains a continued shared control of the object over its entire lifetime, despite any changes of normal ownership and possession over the object.

The Supreme Court today in *Quanta Computer v. LG Electronics* reversed, 9-0, the erosion of the first sale rule via change of default rules and via the exception of certain kinds of patents. LG Electronics had licensed its patents to Intel, and Intel sold chips it made using that technology to Quanta, and LG sued Quanta for infringement. The Supreme Court held that all kinds of patents are covered by the first sale rule, and that the default (implied) patent license terms assume no further rights of the patent holder over the object:

> The authorized sale of an article that substantially embodies a patent exhausts the patent holder's rights and prevents the patent holder from invoking patent law to control postsale use of the article. Here, LGE licensed Intel to practice any of its patents and to sell products practicing those patents. Intel's microprocessors and chipsets substantially embodied the LGE Patents because they had no reasonable noninfringing use and included all

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Nick Szabo

"A premier thinker about history, law and economics, and the lessons they have for security." -- Adam Shostack, Emergent Chaos

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> the inventive aspects of the patented methods. Nothing in the License Agreement limited Intel's ability to sell its products practicing the LGE Patents. Intel's authorized sale to Quanta thus took its products outside the scope of the patent monopoly, and as a result, LGE can no longer assert its patent rights against Quanta. Accordingly, the judgment of the Court of Appeals [Federal Circuit] is reversed.

LG Electronics thought it could restrict subsequent use of the chips, and indeed had a cause of action directly against subsequent users of the chips (e.g. Quanta), via its license agreement with *Intel*. The Federal Circuit agreed with this pathological reasoning, but the Supreme Court shot them down:

> LGE points out that the License Agreement specifically disclaimed any license to third parties to practice the patents by combining licensed products with other components. But the question whether third parties received implied licenses is irrelevant because Quanta asserts its right to practice the patents based not on implied license but on exhaustion.

Imagine Alice could make a contract with her friend Bob which gave Alice the right to confiscate things that you or anybody else bought from Bob. If property rights would be confiscated from third parties by contract on ad-hoc basis, there would be no effective property rights. Contracts should never be able to impose duties on third parties. Only property law (via deeds, licenses, etc.) can impose duties on subsequent owners or licensees, and these transactions should strictly adhere to conservation of rights and intellectual property exhaustion if they are not to interfere with others' property rights.

For property deeds to impose duties on subsequent owners, they must either be clear from the object itself (e.g. a physical object is obviously personal property clearly belongs to somebody) or they must be clearly written and publicly recorded (e.g. liens on personal property, real property deeds that define property boundaries and restrict use of the property, etc.) Furthermore, there should generally be *one* set of restrictions based on *one* owner per object, or simple and well-known variations on that (e.g. joint tenancy), not a wide variety of restrictions stemming from a wide variety of people who "own" the object in different ways, i.e. intellectual property owners. An intellectual property license, when as here is not clear, should be construed to follow the default rules of intellectual property law, especially those rules like patent exhaustion that preserve a standard sphere of traditional property rights not entangled in a web of intellectual property.

My kudos go out to our highest court for defending traditional property rights against further erosion by the Federal Circuit's pathological interpretations of intellectual property law.

Here is Dennis Crouch's take on the case.

Posted by Nick Szabo at 10:32 AM

1 comment:

Clayton said...

Abolish IP!

10:41 AM

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